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THE DEFENSE CONTRACT MANAGEMENT COMMAND
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JUN 30 1997

IN REPLY
REFER TO

AQOC

MEMORANDUM FOR COMMANDERS, DEFENSE CONTRACT MANAGEMENT DISTRICTS

SUBJECT: DCMC Memorandum No. 97- 59 , Procurement of Single Audits by Recipients of Federal Awards (POLICY)

This is a POLICY memorandum. It expires when content is included in DLAD 5000.4, Contract Management (One Book), not to exceed one year. Target Audience: All Administrative Grants Officers (AGOs), Grants Administrators, Operations Group Chiefs and Small Business Specialists.

This memorandum addresses the acquisition of audit services by recipients of Federal grants and cooperative agreements. It also addresses situations in which recipients receive rebates or discounts from accounting firms that should then be credited to the Government. These two areas were identified in a recent Department of Defense Inspector General (DoD IG) report as being appropriate for corrective action.

The Single Audit Act of 1984, as amended, and Office of Management and Budget (OMB) Circulars require that nonprofit organizations which receive \$300,000 or more in a year in Federal awards will procure audit services from independent public accountants to examine financial statements, internal controls and compliance with laws and regulations. These recipients, in turn, pass these costs to the Government as an expense charged to individual awards. Federal reviewers and auditors also do some independent and/or coordinated examination of these institutions and organizations.

OMB Circular A-133, "Audits of Institutions of Higher Education and Other Nonprofit Organizations," Paragraph .305 (a) Auditor Procurement, and OMB Circular A-110, "Uniform Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," Paragraph .43 Competition, (Attachments 1 and 2 respectively) require recipients to provide for free and open competition, to the maximum extent practical, when procuring audit or other services. This guidance states that awards shall be made to the offeror whose bid is responsive to the solicitation and is most advantageous to the recipient, with price, quality and other factors considered. To ensure compliance with these requirements, AGOs should be instructed to advise nonprofit recipients for which DCMC is the cognizant grant/cooperative agreement administration activity of the requirement that recipient contracting decisions be appropriately documented. Such decisions must also comply with the provisions of the OMB Circulars as well as with the recipient's own procurement policies and procedures. This is especially critical if auditor selection is made outside the purview of the purchasing department.

The second issue identified by the DoD IG concerns rebates related to audit services. OMB Circular A-122, "Cost Principles for Nonprofit Organizations," Paragraph A. 5, Applicable Credits, provides that applicable credits, (as defined in Attachment 3 to this memorandum) be credited to the Government when they relate to an allowable cost. Credits may include audit fee refunds, cash contributions in exchange for providing audits, discounts or rebates. However, be aware that not all contributions made by a vendor to a nonprofit organization constitute a rebate. In order to be considered a rebate, the

contribution must be related to the audit in some way, e.g., related to the price of the audit or the performance of the audit. Since the costs of audit services are allowable charges against Federal awards, a percentage of the rebates received by recipients which is related to audit services shall be credited to the Government. Accordingly, AGOs should be instructed to contact all DCMC administered nonprofit recipients to determine if rebates have been received from auditing firms and not properly credited to grants or cooperative agreements beginning December 31, 1993. Districts shall provide to AQOC by August 31, 1997, a summary of rebates identified and actions to recover.

On a related topic, AGOs should be aware that nonprofit recipients are exempt from Federal audit requirements for any year in which they expend less than \$300,000 in Federal awards. In such cases, reviews performed by AGOs may be the only surveillance of the recipient's expenditures. If a recipient has not obtained an independent audit, AGOs should ensure that appropriate reviews of expenditures are conducted on grants and cooperative agreements, particularly when payment requests or other data indicate cost overruns or possibly unallowable expenditures. Reviews do not need to be complete audits, but should be adequate in scope to provide a measure of confidence in the accuracy of payment requests and financial reports submitted under the assistance agreement. Reviews may be conducted by the Defense Contract Audit Agency, or by the AGO or financial surveillance personnel. Any reviews should be coordinated to ensure that there is no duplication of audit effort.

Contract administration office personnel should have ready access to all of the OMB Circulars impacting the administration of grants, cooperative agreements and Other Transactions. These circulars can be downloaded off the OMB Homepage at the following address <http://www.whitehouse.gov/WH/EOP/omb>. As an alternative, copies may be obtained by calling OMB at (202) 395-7332.

The DCMC Headquarters point of contact for this memorandum is Timothy Frank, Business Practices and Contract Payment Team, (703)767-3431, or DSN 427-3431. The Internet address is tim_frank@hq.dla.mil.



ROBERT W. DREWES
Major General, USAF
Commander

Attachments

- (c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.
- (d) Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with § ___.310.
- (e) Ensure that the audits required by this part are properly performed and submitted when due. When extensions to the report submission due date required by § ___.320(a) are granted by the cognizant or oversight agency for audit, promptly notify the central clearinghouse designated by OMB and each pass-through entity providing Federal awards of the extension.
- (f) Follow up and take corrective action on audit findings, including preparation of a summary schedule of prior audit findings and a corrective action plan in accordance with § ___.315(b) and § ___.315(c), respectively.

§ ___.305 Auditor selection.

- (a) **Auditor procurement.** In arranging for audit services, auditees shall follow the procurement standards prescribed by Circular A-110, "Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations," or the Federal Acquisition Regulation (48 CFR part 42), as applicable. Whenever possible, auditees shall make positive efforts to utilize small businesses, minority-owned firms, and women's business enterprises, in procuring audit services as stated in OMB Circular A-110 or the Federal Acquisition Regulation (48 CFR part 42), as applicable. In requesting proposals for audit services, the objectives and scope of the audit should be made clear. Factors to be considered in evaluating each proposal for audit services include the responsiveness to the request for proposal, relevant experience, availability of staff with professional qualifications and technical abilities, the results of external quality control reviews, and price.
- (b) **Restriction on auditor preparing indirect cost proposals.** An auditor who prepares the indirect cost proposal or cost allocation plan may not also be selected to perform the audit required by this part when the indirect costs recovered by the auditee during the prior year exceeded \$1 million. This restriction applies to the base year used in the preparation of the indirect cost proposal or cost allocation plan and any subsequent years in which the resulting indirect cost agreement or cost allocation plan is used to recover costs. To minimize any disruption in existing contracts for audit services, this paragraph applies to audits of fiscal years ending on or after June 30, 1999.
- (c) **Use of Federal auditors.** Federal auditors may perform all or part of the work required under this part if they comply fully with the requirements of this part.

§ ___.310 Financial statements.

- (a) **Financial statements.** The auditee shall prepare financial statements that reflect its financial position, results of operations, and, where appropriate, cash flows for the fiscal year audited. The financial statements shall be for the same organizational unit and fiscal year that is chosen to meet the requirements of this part.
- (b) **Schedule of expenditures of Federal awards.** The auditee shall also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements. While not required, it is appropriate for the auditee to provide information requested to make the schedule easier to use by Federal awarding agencies and pass-through entities. For example, when a Federal program has multiple award years, the auditee may list the amount of each award year separately. At a minimum, the schedule shall:
 - (1) List individual Federal programs by Federal agency and major subdivision within a Federal agency. For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity shall be included.

real property and other services with Federal funds. These standards are furnished to ensure that such materials and services are obtained in an effective manner and in compliance with the provisions of applicable Federal statutes and executive orders. No additional procurement standards or requirements shall be imposed by the Federal awarding agencies upon recipients, unless specifically required by Federal statute or executive order or approved by OMB.

.41 Recipient responsibilities. The standards contained in this section do not relieve the recipient of the contractual responsibilities arising under its contract(s). The recipient is the responsible authority, without recourse to the Federal awarding agency, regarding the settlement and satisfaction of all contractual and administrative issues arising out of procurements entered into in support of an award or other agreement. This includes disputes, claims, protests of award, source evaluation or other matters of a contractual nature. Matters concerning violation of statute are to be referred to such Federal, State or local authority as may have proper jurisdiction.

.42 Codes of conduct. The recipient shall maintain written standards of conduct governing the performance of its employees engaged in the award and administration of contracts. No employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, or agent, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award. The officers, employees, and agents of the recipient shall neither solicit nor accept gratuities, favors, or anything of monetary value from contractors, or parties to subagreements. However, recipients may set standards for situations in which the financial interest is not substantial or the gift is an unsolicited item of nominal value. The standards of conduct shall provide for disciplinary actions to be applied for violations of such standards by officers, employees, or agents of the recipient.

.43 Competition. All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals shall be excluded from competing for such procurements. Awards shall be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered. Solicitations shall clearly set forth all requirements that the bidder or offeror shall fulfill in order for the bid or offer to be evaluated by the recipient. Any and all bids or offers may be rejected when it is in the recipient's interest to do so.

.44 Procurement procedures.

(a) All recipients shall establish written procurement procedures. These procedures shall provide for, at a minimum, that (1), (2) and (3) apply.

1. Recipients avoid purchasing unnecessary items.
2. Where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the Federal Government.
3. Solicitations for goods and services provide for all of the following.
 - (i) A clear and accurate description of the technical requirements for the material, product or service to be procured. In competitive procurements, such a description shall not contain features which unduly restrict competition.
 - (ii) Requirements which the bidder/offeror must fulfill and all other factors to be used

(3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

b. Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award.

5. Applicable credits.

a. The term applicable credits refers to those receipts, or reduction of expenditures which operate to offset or reduce expense items that are allocable to awards as direct or indirect costs. Typical examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing or received by the organization relate to allowable cost, they shall be credited to the Federal Government either as a cost reduction or cash refund, as appropriate.

b. In some instances, the amounts received from the Federal Government to finance organizational activities or service operations should be treated as applicable credits. Specifically, the concept of netting such credit items against related expenditures should be applied by the organization in determining the rates or amounts to be charged to Federal awards for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by Federal funds.

c. For rules covering program income (i.e., gross income earned from federally-supported activities) see Sec. __.24 of Office of Management and Budget (OMB) Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations."

6. *Advance understandings.* Under any given award, the reasonableness and allocability of certain items of costs may be difficult to determine. This is particularly true in connection with organizations that receive a preponderance of their support from Federal agencies. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, it is often desirable to seek a written agreement with the cognizant or awarding agency in advance of the incurrence of special or unusual costs. The absence of an advance agreement on any element of cost will not, in itself, affect the reasonableness or allocability of that element.

B. Direct Costs

1. Direct costs are those that can be identified specifically with a particular final cost objective, i.e., a particular award, project, service, or other direct activity of an organization. However, a cost may not be assigned to an award as a direct cost if any other cost incurred for the same purpose, in like circumstance, has been allocated to an award as an indirect cost. Costs identified specifically with awards are direct costs of the awards and are to be assigned directly thereto. Costs identified specifically with other final cost objectives of the organization are direct costs of those cost objectives and are not to be assigned to other awards directly or indirectly.

2. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives.

3. The cost of certain activities are not allowable as charges to Federal awards (see, for example, fundraising costs in **paragraph 19 of Attachment B**). However, even though these costs are unallowable for purposes of computing charges to Federal awards, they nonetheless must be treated as direct costs for purposes of determining indirect cost rates and be allocated their share of the organization's indirect costs if they represent activities which (1) include the salaries of personnel, (2) occupy space, and (3) benefit from the organization's indirect costs.

4. The costs of activities performed primarily as a service to members, clients, or the general public